

## 100-day tax reforms agenda

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The administrative burden of tax compliance is hardest in Pakistan where firms have to make 47 payments and spend 594 hours (or 74 man days per year) dealing with tax regulations versus 12 payments and 175 hours in high income OECD countries-Toward a More Business Friendly Tax Regime: Key Challenges in South Asia, World Bank, December 2015.

Except Pakistan Tehreek-e-Insaf (PTI), no other political party has prepared or unveiled its first 100-day plan, if elected in elections, to be held on July 25, 2018. Pakistan People Party (PPP) and Pakistan Muslim League (Nawaz)-[PMLN] were quick to denounce 'First 100-Day Plan of PTI' without bothering to tell the nation what they would do if elected to form federal government to deal with pressing economic issues like inadequate revenue of less than Rs 8 trillion to overcome perpetual fiscal deficit, public debt of 72% of GDP that is Rs 24.5 trillion as on June 30, 2018 (domestic debt of Rs 16.5 trillion and external debt of Rs 8 trillion), record fiscal deficit of Rs 2.5 trillion, trade deficit of \$ 37.7 billion and circular debt of Rs 850 billion-just to mention a few.

While the political parties, except PTI, appear indifferent towards any concrete plan, the document, '100-Day Economic Agenda for the Incoming Government', launched by Pakistan Business Council (PBC) on July 9, 2018, also went unnoticed in the mainstream media which is since July 6, 2018 more interested in determining the future of Nawaz Sharif and his daughter as if only individuals matter and not parties. This is the dilemma of all the parties in Pakistan. They believe like voters, in idol-worshipping of a supreme leader-for PTI Imran Khan, for PPP Zulfikar Ali Bhutto and for PMLN always Nawaz Sharif! Programmes for good governance have secondary status and the weakest link of our democracy.

None of the political parties or tax bar or even PBC that has presented '100-Day Economic Agenda for the incoming government' bothered to ask the caretaker government to make public, report of the Tax Reform Commission (TRC). This report could have been a good starting point of discussion for preparing a common reform agenda, no matter which party wins. This report is marked "confidential". This is how we run the state. The governments establish Commissions and then hide their reports. Nobody asked the ex-Finance Minister, now a fugitive, why he did not make public the report of TRC in utter violation of Article 19A of the Constitution. It is also not understandable that why the chairman and members of TRC failed to press for publication of this report for open debate and instead a few of them decided to become part of an implementation committee holding closed doors meetings with bureaucrats. In democracy, such practices are highly undesirable. Public related important issues involving various stakeholders should be debated in a transparent manner to seek a consensus before implementation. The Parliament also did not take Ishaq Dar to task for not presenting the report of TRC in the National Assembly and Senate.

The first thing the new government should do is to make the report of TRC public and seek comments from all stakeholders. Good work done by TRC has been shelved by keeping it away from the public domain. Tax reforms, or for that matter comprehensive restructuring of all state institutions for better delivery, should be a national agenda, but who bothers about it?

It is a fact that even after levying all kinds of oppressive taxes and expanding the scope of withholding taxes to an insane level, the federal government has failed to bridge the ever-increasing fiscal deficit that is leading towards a greater debt burden-at present 65% of tax revenues are going towards debt servicing alone. Everybody is critical of inefficiencies on the part of Federal Board of Revenue (FBR) but not ready to implement the alternatives given by TRC.

The administration of a tax system requires specific skills and qualifications-these are missing at the top level in Pakistan. No doubt, a proper input from FBR is vital for making the system successful but it is

equally necessary to take all the stakeholders on board. On the issue of revival of circle system in IRS, wide support is available now-tax officials, tax bars and trade bodies have endorsed it. In fact, there is consensus on this subject in the wake of complete failure of the functional system. Unfortunately, this issue, which deserved utmost priority, was neglected under all tax reform efforts or advisory committees. The TRC in its report also did not give due attention to revival of circle system.

The exercise relating to tax reforms cannot be a time-bound affair and does not mean merely making changes in tax laws or suggesting cosmetic changes here and there. Reforms can be successful only if comprehensive analysis is made of the whole system, that is, tax structure, tax administration, state of economy, taxpayers' attitude, revenue needs of the country and so many other allied aspects.

### **Measures that are necessary to make a tax system functional and effective relate to:-**

1. devising and running an efficient and truly independent tax justice system;
2. expert legal advice for drafting of laws;
3. designing tax forms and procedures;
4. innovations in tax management;
5. broad-based personnel policy;
6. effective intelligence, especially under-cover operations;
7. taxpayers' education;
8. development of work ethics;
9. healthy working conditions; and
10. efficient redressal of problems faced by taxpayers.

Present income tax law is a most undesirable piece of legislation. Direct tax system intends to achieve the twin aims of maximizing revenue as well as achieving socio-economic justice. Our tax system is achieving none of these. FBR has been running after small fry to broaden the tax net. For example, persons owning a car, telephone etc has to file a return whether he has taxable income or not. Such an exercise generates tremendous infructuous, unproductive and wasteful workload without any significant gain to the revenue. It strengthens the feeling that the government, unable to tackle the hardened tax evaders (for example sharks at stock exchanges who engulf small investors), is unduly harsh on vulnerable salary and wage earners. A feeling goes around that they are made to bear the major burden of taxes. Consequently the ordinary people who generally consider themselves as honourable and honest end up in participating or advising others to avoid filing returns and paying taxes!

Fair taxation is at the heart of establishing a true social democracy, which we lack. Complex laws and cumbersome procedures give unbridled powers and discretion to tax authorities and these should be discarded if we want real and meaningful tax reforms.

It is a sad fact and bitter reality that the parliamentarians failed to enact fiscal laws through consultative process as ordained by the Supreme Court in *CIT v Eily Lilly & Others* [2009 PTR 23 Supreme Court] as under:

"Since the creation of Pakistan we have not been able to frame any Income Tax Act duly debated in the Assembly. Both the Ordinances were promulgated during the Martial Law Regime otherwise the

Constitution has prescribed a four month life of an Ordinance in case the Ordinance is not be placed before the Assembly and it shall be enacted as an Act then the Ordinance will automatically cease to exist. This aspect also reveals that the Constitution has cast duty upon the legislative body to frame the laws within the parameters prescribed under the scheme of the Constitution"....The fact that the Ordinance in question was issued and various amendments were incorporated before and even after the enforcement of the Ordinance 2001 raises the controversy that the Ordinance in question was promulgated without meticulous debate on the subject due to which taxpayers and concerned departments were compelled to agitate the issues in different courts."

Our elected members hardly take any interest in enacting tax laws that can make a difference in the lives of ordinary people. They themselves openly defy tax laws-Tax Directories for 2013, 2014, 2015 and 2016, published by FBR, show that barring a few worthy exceptions, the sums paid as income tax by most of the elected representatives are laughably low.

The most important factor that discourages compliance with intricate tax laws is the extremely complicated and cumbersome nature of procedure involved in being registered with the revenue authorities. Even the corporate and educated classes find it difficult to comprehend, follow and observe the simultaneously applicable innumerable legal obligations, what to talk of the illiterate and ordinary man on the street. If a survey is conducted with respect to merely the advance tax provisions (almost 55 in number), it would reveal how a person is supposed to be aware of so many avenues where either tax is being withheld or he is himself paying income tax and the consequences of these taxes, the credit of which he may or may not be allowed to take while filing his return. In the first instance, a highly meticulous record of all such transactions that invoke taxes would have to be maintained and secondly, an even higher level of grasp over the law would be required to apply it.

Revenue officers are trained to look suspiciously at every registered taxpayer-their motto being "guilty until proven innocent." Tax law should be redrafted and re-enacted for achieving simplicity. Taxpayer should be provided guidance and assistance with respect to their duties and rights. Presently they are compelled to engage a tax consultant who, if professionally unethical, is capable of causing much more financial damage to his client than the amount of tax in question.

The tax system that will work smoothly for Pakistan, keeping in view our peculiar socio-economic circumstances and mindset of businessmen, must be a low-rate, flat-rate with no compliance hassles. It is aptly observed in the report by Anna Reva in 'Toward a More Business Friendly Tax Regime: Key Challenges in South Asia' (World Bank, December 2015) that "high business taxes discourage investment due to decrease in revenue and an increase in sales taxes reduces spending". The report says that "despite having such a big population, only 1.2 million individuals and firms file their income tax returns in Pakistan. Half of these tax filers are from the corporate sector. About 118,000 firms are enrolled to pay sales taxes, however, only 15,000 actually pay any tax at all". In is a bitter fact, the report observes that "the Pakistani government continues to give tax incentives to privileged firms despite the small tax base nationwide. This approach benefits the few high-revenue businesses which are already settled in the market while deteriorating the overall investment environment in the country. This also puts extra pressure on the already small number of taxpayers, the report states".

All taxes should be merged into one single tax with complete assurance to the masses that they would be free from any kind of harassment; and money collected would be spent towards their welfare. The agenda of fair taxation cannot succeed if wastage of public funds and its abuse by the rulers continue unabated. The quid pro quo for paying taxes is as important as the system employed for collecting them. Where the public is blamed for not paying their due share, public authorities are equally, if not more, responsible for indulging in corrupt means taking cover of complicated procedures that eventually lead to poor collection of revenue.

The provinces should also work for better and efficient tax collection. Presently they are isolated and rely on distribution from the divisible pool whereas FBR annually collects less than the assigned revenue target. For the just ended fiscal year, 2017-18, the then government of PLM-N allocated the revenue target of Rs 4013 billion to FBR that was later revised downward to Rs 3935 billion. FBR collected only

Rs 3751 billion. It collected income tax of Rs 1441 billion against the target of Rs 1562 (deficit of Rs 121 billion). Sales tax collection at Rs 1488 billion against target of Rs 1541 billion witnessed shortage of Rs 53 billion. FBR also faced a shortfall of Rs 16 billion under the head Federal Excise Duty as it collected Rs 216 billion whereas the target was Rs 232 billion. Only collection under customs exceeded the target by Rs 6 billion against the assigned target of Rs 600 billion. The overall shortfall of Rs 184 billion vis-à-vis the revised target of Rs 3935 billion and that of Rs 262 from original target pushed the fiscal deficit to a record Rs 2.5 trillion as on June 30, 2018. The expected windfall of nearly Rs 100 plus billion under amnesty schemes-domestic and foreign-till July 31, 2018, if not further extended, will not help much in easing our economic woes unless we take concrete measures to fix governance issues, enforce fiscal discipline, besides taking paradigm shifts in bureaucratically-designed policies as suggested by TRC (in parts as reported by the Press so far) and by eminent economist, Dr Nadeem Ul Haque I his excellent book, Looking Back: How Pakistan Became an Asian Tiger by 2050.

If we want to improve tax collection and win the confidence of taxpayers, it is imperative to replace FBR with a national tax agency. The responsibility to collect revenues should be joint and several giving a participative sense to all federating units. If we want optimum collection of taxes fairly and without hampering growth, it is imperative to abolish the present tax laws and enact new ones. Collection of taxes should be through a single National Tax Agency (NTA). National and provincial assemblies should pass a law agreeing on establishment of NTA responsible for collecting all taxes imposed by the federal and provincial governments. This would facilitate people to deal with a single revenue authority rather than multiple agencies at national, provincial and local levels. The mode and working of NTA can be discussed and finalised under Council of Common Interests [Article 153] and its control can be placed under National Economic Council [Article 156]. The NTA should consist of officers and staff representing the federation of Pakistan as in taxes, both the centre and provinces have equal stakes. If the size of the pie grows, every federating unit will get more and the Centre will also have more money at its disposal. For NTA, an all Pakistan Tax Service should be established. Recruitment for All Pakistan Tax Service must be independent of the present Central Superior Services structure. Competent people having knowledge in accounting, law, IT and administration should be selected through a special Board, comprising members from the existing Federal and Provincial Public Service Commissions.

The need of the hour is establishment of a Tax Intelligence System. This system should send quarterly information to potential taxpayers about their economic activities so that they can be informed in advance as to how their incomes and expenditure should finally look like in their tax declarations. The tax base with respect to direct tax vis-à-vis fair distribution of incidence can be achieved by imposing 10% flat rate tax on net income of individuals with alternate minimum tax of 2.5% on net wealth. Corporate tax rate should be reduced to 20%. This kind of simple taxation would induce voluntary compliance provided all the citizens are aware of the fact that competent and effective tax machinery exists having a tax intelligence system that can easily detect tax avoidance. Without this deterrence even the new system which is a great deal simpler, will become unworkable. Nowhere in the world is proper collection of taxes possible without a strong enforcement apparatus. However, the apparatus should be friendly and firm-friendly, to the extent of educating and guiding the people for fulfillment of their tax obligations, and firm to the extent of punishing willful defaulters.

According to available data, total number of persons having taxable income of more than Rs 800,000 is about 10 million and tax base is around Rs 50 trillion (after taking into account informal economy). Flat rate taxation of just 10% with strong enforcement system will yield income tax of Rs 5 trillion. If amnesty for earlier years is given for the next five years at the rate of 10% for local and foreign assets, not less than further Rs 3 trillion can also be collected in the next 5 years in addition to regular collection.

As far as sales tax is concerned, it has been emphasized time and again by all, including the TRC, that Pakistan needs lower rate harmonized sales tax (HST).-further details can be seen in a published paper, Towards Flat, Low-rate, Broad and Predictable Taxes, available at <http://primeinstitute.org/wp-content/uploads/2016/08/Towards-Flat-Low-rate-Broad-and-Predictable-Taxes.pdf>

The new government in its first 100-days should work to replace all existing indirect taxes, both at the federal and provincial levels, with Harmonized Sales Tax (HST) on goods and services. There are

multiple tax collection authorities now, rendering the life of businessmen miserable since they are unable to comprehend complex laws without having to pay heavily to professionals. If the present indirect taxation is replaced with HST as in a comparable federation like Canada, it would not only improve revenue collection but would also help to alleviate the sufferings of taxpayers who have to deal with multiple tax authorities. In the Pakistani milieu if 9% HST is levied, it would yield at least Rs 3 trillion giving substantial fiscal space to both federal and provincial governments.

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